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When is Private Investment Not Private Investment?

When Government's the One Investing (Social Security Money)

Social Security and private investment: only a short time ago, the combination was politically unthinkable. But, following the opening rounds of the President's conference on Social Security last week, that potential marriage increasingly is being viewed as a viable option. Yet, as policy-makers seriously examine the issue of Social Security reform, we offer this caveat: government investment in the private sector is *not* private investment. It's closer to manipulation of the free marketplace, and as such, it actually could undermine the free enterprise system.

Social Security: The Future is Coming

The chairman of the House Ways and Means Committee, Bill Archer, last month laid out Congress' goals for Social Security: that it be fair to current and future retirees, especially women; that there be no tax increases; that it remain a safety net for the needy and disabled; and that there be new options for younger workers. If President Clinton is honestly attempting to take some cautious steps in moving beyond the pledge he made last January, and seriously moving toward bipartisan reform, this Congress awaits with eagerness. It is commendable if the President has acknowledged that:

- the Social Security problem is both a major and an immediate one — 2013 — and not one that can be fixed by minor adjustments sometime in the future;
- tax increases are not the solution; (Faced with exploding future costs and payroll taxes already taking 12.4 percent from workers' paychecks, this is not a problem that we can tax our way out of.)
- the best way to reform Social Security is to increase its currently low rate of return to beneficiaries — and that this is best done through investment in the private sector.

However, a distinction needs to be made immediately lest the President allow his first steps forward to take us in the wrong direction. Because private-sector investment by the federal government is not private investment, such a proposal will not only undermine the goals of Social Security reform, it will undermine the private-sector economy itself. In short, government investment is simply too risky.

What's Wrong With Government Investment?

Taxpayers' confidence in Social Security is already very low. A poll conducted with GOP pollster Frank Luntz four years ago found that more young Americans believe in UFOs than believe that Social Security will be there for them when they retire. Clearly, our first goal in reforming Social Security should be to increase people's confidence. Yet, a recent (12/9/98) *Associated Press* poll showed that while 75 percent of people favored allowing payroll tax receipts in the stock market, 68 percent opposed the government doing it. The President himself acknowledged this situation: "How will you ever convince the American people . . . since they always believe the government will mess up a two-car parade?" *[Orlando Sentinel,* 11/29/98].

And taxpayers have good reason to be wary of government investment. Here's what Federal Reserve Chairman Alan Greenspan had to say about government investment of Social Security receipts in a hearing before the Senate Banking Committee on July 21, 1998: "I think it's very dangerous . . . I don't know of any way that you can essentially insulate government decision-makers from having access to what will amount to very large investments in American private industry. . . . I am fearful that we are taking on a position here, at least in conjecture, that has very far-reaching potential dangers for a free American economy and a free American society." The following points offer an elaboration of Chairman Greenspan's concern:

- **Having the government pick winners and losers distorts the private economy**. The private sector works best precisely because it makes unbiased decisions based on the concerns of countless investors and customers. Government investment, which would be on a comparatively massive scale, will bias — even if unintentionally — the market toward its investments rather than following the market as true private investment should.

- **Government investment will not be unbiased**. The government, controlled by politicians and bureaucrats, will inevitably succumb to political pressure, ideological interests, and local concerns when making its investments. "Would politicians let taxpayer money buy shares of tobacco companies such as Philip Morris and RJR Nabisco, Inc., which represent 2.4 percent of S&P's 500?" asks James K. Glassman in a recent published column. Or, "what about buying $33 billion worth of Microsoft Corp., the largest S&P stock and a company that the government is prosecuting on antitrust charges? Or stock in firms that use cheap foreign labor, trade with unsavory countries or spread pollution?" [Glassman, *Washington Post,* 12/8/98].

- **Government intervention in nations' economies is a proven failure.** From the complete control of communism, to the state-manipulated investments of Asia these efforts have all met with failure. Even the recent massive stock purchases by the Hong Kong government, which amounts merely to indirect control, have shaken international finance markets' confidence in what had until recently been considered one of the world's best markets.

Furthermore, the costs of government investment will inevitably be paid by Social Security beneficiaries, the economy and the nation as a whole. All the problems outlined lead to lower returns on investment.

- **Social Security beneficiaries will suffer.** That's because Government investments — that distort the private sector and are influenced by political decisions — will inevitably lead to lower returns than otherwise would have occurred.

- **The economy will also suffer.** That's due to massive shifts in resources to areas where they otherwise would not have gone causing the economy to use them less productively than they should have been. This means lower economic growth — fewer jobs, lower wages, and lower profits — than would otherwise have resulted.

- **Finally, the nation will suffer.** Lower returns for Social Security beneficiaries, workers, employers, and investors all mean greater demands on the government (for subsidies, unemployment benefits, etc.) and lower resources with which to meet these demands — i.e., lower tax revenues. Lower revenues means that the government must borrow the money — which reinforces the negative economic performance — or that people do without — precisely the opposite of our Social Security reform efforts.

In short, government investment in the private sector is too risky — not simply for Social Security, but for the economy and nation as well.

What About Individual Investment of Social Security Dollars?

To be truly private, investment must be under the control of individuals — not bureaucrats and politicians. Again quoting from Fed Chairman Greenspan: "I am strongly supportive of going to private funding where individuals control the claims on corporations." What are the options?

- One option is privately-held and privately-administered accounts with qualified outside entities — such as those currently used on a large scale in such instruments as IRAs and 401(k) plans.

- Another option is privately controlled personal accounts with diversified but limited investment options that are administered by an independent private entity — such as is currently done on a large scale with the federal employees' retirement savings under the Thrift Savings Plan (TSP). This system allows for safeguards for investors as well as minimal transaction costs — thus maximizing the investor's security and return. [See, for an elaboration, RPC's paper, "Could Congress' Retirement Plan Serve as a Model to Reform Social Security?", 3/10/98.]

Social Security desperately needs, and its beneficiaries deserve, the higher rates of return offered by private investment. However, no one should be deluded or encouraged that government investment is private investment or that it will achieve the reform that Social Security needs.

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